

*AS*

The Parliament of the Commonwealth of Australia

Joint Committee of Public Accounts  
and Audit

DEPARTMENT OF THE SENATE
PAPER No 7
DATE
PRESENTED
10 NOV 1998
<i>Mary Evans</i>

## REPORT 363

**Asset Management by  
Commonwealth Agencies**

July 1998



COMMONWEALTH OF AUSTRALIA  
DEPARTMENT OF THE TREASURY  
TAXATION

Asset Management by  
Commonwealth Assets

1997-1998

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## CHAIRMAN'S FOREWORD

The Joint Committee of Public Accounts and Audit has a continuing interest in promoting good management practices in Commonwealth agencies. Previous Committee reviews have focussed on topics such as accrual accounting, cash management and whole of government reporting.

This review of asset management has in part arisen from two performance audits by the Auditor-General of the asset management performance of Commonwealth agencies.

It appears to the Committee that many agencies regard asset management as a minor component of their management responsibility. Such a view is mistaken.

The Commonwealth holds substantial physical and intangible assets. If assets held by government business enterprises and Defence military equipment are omitted, the value of Commonwealth assets in the form of land, buildings and infrastructure, plant and equipment and intangibles amounts to \$32.0 billion.

An estimate presented to the Committee of the potential savings arising from improved asset management indicated a possible capital return of some \$3.5 billion and annual savings of some \$200 million. These figures show that a small percentage gain in asset management would result in substantial savings.

The Committee has reviewed the guidelines concerning asset management issues presently available to agencies. Policy guidance is provided by the Department of Finance and Administration (DoFA) and guidelines on the principles of asset management is provided by the Australian National Audit Office (ANAO). The Committee considers that the degree of guidance provided is adequate and appropriate.

There would be value, however, in agencies sharing the knowledge and skills they have gained. The Committee has recommended the creation of an asset management forum, jointly convened by DoFA and the ANAO, to meet regularly to exchange information on asset management issues.

The Auditor-General has concluded that further progress in asset management performance by agencies is possible. The Committee believes the challenge for many agencies is one of raising awareness of the importance of asset management. A cultural change is needed and this would be promoted by agency senior management embracing the concepts of better asset management.

In this context, the Committee notes that the *Financial Management and Accountability Act 1997* stipulates that chief executives are responsible for promoting efficient, effective and ethical use of Commonwealth resources. The Committee believes this requirement should be developed further and has recommended that evaluation of the performance of agency senior managers should include reference to how efficiently and effectively assets under their control are managed. Agency annual reports should also contain information demonstrating efficient and effective asset management performance.



Bob Charles, MP  
Chairman

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- Mr Bob Charles, MP (Chairman)
- Mr Alan Griffin, MP (Vice-Chairman)
- Senator H Coonan                      Mr L Anthony MP
- Senator the Hon R Crowley              Hon D Beddall MP
- Senator the Hon B Gibson AM              Mr R Broadbent MP
- Senator J Hogg                      Hon J Crosio MP
- Senator A Murray                      Mr J Fitzgibbon MP
- Senator J Watson                      Mr P Georgiou MP
- Hon J Sharp MP
- Mrs S Stone MP
- Secretary:                              Dr Margot Kerley

## MEMBERSHIP OF THE ASSET MANAGEMENT SECTIONAL COMMITTEE

Mr Bob Charles, MP (Chairman)

Mr Alan Griffin, MP (Vice-Chairman)

Senator Brian Gibson

Mr David Beddall MP

Senator Andrew Murray

Inquiry Staff:

Dr John Carter

Ms Georgina Binks

Ms Marie Kawaja

Ms Laura Gillies

## DUTIES OF THE COMMITTEE

The Joint Committee of Public Accounts and Audit is a statutory committee of the Australian Parliament, established by the *Public Accounts and Audit Committee Act 1951*.

Section 8(1) of the Act describes the Committee's duties as being to:

- (a) examine the accounts of the receipts and expenditure of the Commonwealth, including the financial statements given to the Auditor-General under subsections 49(1) and 55(2) of the *Financial Management and Accountability Act 1997*;
- (b) examine the financial affairs of authorities of the Commonwealth to which this Act applies and of intergovernmental bodies to which this Act applies;
- (c) examine all reports of the Auditor-General (including reports of the results of performance audits) that are tabled in each House of the Parliament;
- (d) report to both Houses of the Parliament, with any comment it thinks fit, on any items or matters in those accounts, statements and reports, or any circumstances connected with them, that the Committee thinks should be drawn to the attention of the Parliament;
- (e) report to both Houses of the Parliament any alteration that the Committee thinks desirable in:
  - (i) the form of the public accounts or in the method of keeping them; or
  - (ii) the mode of receipt, control, issue or payment of public moneys;
- (f) inquire into any question connected with the public accounts which is referred to the Committee by either House of the Parliament, and to report to that House on that question;
- (g) consider:
  - (i) the operations of the Audit Office;
  - (ii) the resources of the Audit Office, including funding, staff and information technology;
  - (iii) reports of the Independent Auditor on operations of the Audit Office;

- (h) report to both Houses of the Parliament on any matter arising out of the Committee's consideration of the matters listed in paragraph (g), or on any other matter relating to the Auditor-General's functions and powers, that the Committee considers should be drawn to the attention of the Parliament;
- (i) report to both Houses of the Parliament on the performance of the Audit Office at any time;
- (j) consider draft estimates for the Audit Office submitted under section 53 of the *Auditor-General Act 1997*;
- (k) consider the level of fees determined by the Auditor-General under subsection 14(1) of the *Auditor-General Act 1997*;
- (l) make recommendations to both Houses of Parliament, and to the Minister who administers the *Auditor-General Act 1997*, on draft estimates referred to in paragraph (j);
- (m) determine the audit priorities of the Parliament and to advise the Auditor-General of those priorities;
- (n) determine the audit priorities of the Parliament for audits of the Audit Office and to advise the Independent Auditor of those priorities; and
- (o) undertake any other duties given to the Committee by this Act, by any other law or by Joint Standing Orders approved by both Houses of the Parliament.

## TERMS OF REFERENCE

The Commonwealth Government has announced that it intends to introduce a new accrual based financial management and budgeting framework for Commonwealth agencies. The new framework will be in place from the financial year 1999-2000. In this context the Joint Committee of Public Accounts and Audit shall inquire into and report on the effectiveness and efficiency with which Commonwealth agencies manage the non financial assets for which they are responsible.

The Committee will consider, in particular:

- (a) the impact of the Government's proposed accrual based management framework on Commonwealth asset management policies and practices, and what is needed to facilitate the change to the new environment;
- (b) the effectiveness with which individual agencies currently manage the assets for which they are responsible and their capability to meet the demands of the new accrual environment; and
- (c) the potential for the introduction of greater efficiencies in the new environment in the way that Commonwealth agencies manage assets.



## LIST OF ABBREVIATIONS

ANAO	Australian National Audit Office
ASCPAs	Australian Society of Certified Practising Accountants
CEO	Chief Executive Officer
Defence	Department of Defence
DoFA	Department of Finance and Administration
DFAT	Department of Foreign Affairs and Trade
DHFS	Department of Health and Family Services
FMA	<i>Financial Management and Accountability Act 1997</i>
IT	Information Technology
JCPA	Joint Committee of Public Accounts
JHD	Joint House Department

## RECOMMENDATIONS

### CHAPTER TWO - THE NEW FRAMEWORK

#### Recommendation 1

*The Department of Finance and Administration and the Australian National Audit Office should jointly convene an Asset Management Forum. The Forum should comprise interested Commonwealth agencies and should meet regularly, provided the need exists, to exchange information on asset management issues. (paragraph 2.59)*

### CHAPTER THREE - THE MANAGEMENT OF ASSETS

#### Recommendation 2

*Measurement of the performance of the senior management, including Chief Executive Officers, of Commonwealth agencies should include reference to how efficiently and effectively assets under their control are managed. (paragraph 3.46)*

#### Recommendation 3

*The annual reporting guidelines for Commonwealth agencies should be amended to require agencies to provide information indicating how efficiently and effectively agency-controlled assets have been managed. (paragraph 3.47)*



## INTRODUCTION

### Background to the inquiry

#### *Asset management*

1.1 The Commonwealth holds a substantial amount of physical and intangible assets. At 30 June 1997, Commonwealth assets amounted to some \$113.8 billion, of which some \$72.5 billion was held in the general government sector.<sup>1</sup> After deducting the value of Defence military equipment, the remainder, comprising land, buildings and infrastructure, plant and equipment, and intangibles amounts to \$32.0 billion.<sup>2</sup>

1.2 Consequently, improvements in the management of these assets, even if small in percentage terms, can result in significant savings for the Commonwealth.

1.3 The task, however, is demanding because the long life of assets mean that management decisions can take up to ten years to take effect. In addition, there are at present, 'no prizes for managing assets well in the Commonwealth.'<sup>3</sup>

1.4 The Australian National Audit Office (ANAO) in its publication, *Asset Management Handbook*, describes asset management as the process 'of planning and monitoring physical assets during their useful lives to an agency'. To do so effectively requires constant management interest after the

---

1 This sector receives funds from taxation receipts and does not include government business enterprises.

2 Auditor General, *Audit Report No. 41, 1997-98, Financial Control and Administration Audit, Asset Management*, AGPS, Canberra, 1998, p. 1.

3 Coopers & Lybrand, *Transcript*, p. 22.

acquisition stage. The objective of asset management is to 'achieve the best possible match of assets with program delivery strategies'.<sup>4</sup>

1.5 Asset management is therefore not a goal in itself, but one important factor in an agency's total corporate governance.

#### *The Committee's interest*

1.6 The Joint Committee of Public Accounts and Audit has a continuing interest in promoting good management practices in government agencies, including good asset management. In August 1995, the then Joint Committee of Public Accounts (JCPA) tabled its *Report 338, Accrual Accounting—A Cultural Change*. In that report the JCPA noted that one benefit of accrual accounting is its potential to provide for improved asset management.

1.7 Accrual accounting requires the identification of the assets controlled by the agency. If managers are aware of the value of these assets, and the uses to which they are put, they are able to make better decisions on the utilisation, retention and sale of these assets. Managers are also able to make improved decisions on whether current levels of provision for asset maintenance are appropriate.<sup>5</sup>

1.8 During late 1995, the JCPA reviewed the Commonwealth's financial reporting requirements and tabled its report of the inquiry, *Report 341*, in November 1995.<sup>6</sup> In the report the Committee emphasised the value of agencies developing and using consistent asset recognition and valuation policies and recommended that the Department of Finance and the ANAO should, as a priority, develop a framework for the recognition and valuation of Commonwealth assets managed by Commonwealth agencies.<sup>7</sup>

<sup>4</sup> ANAO, *Asset Management Handbook*, ANAO, 1996, p. 2.

<sup>5</sup> JCPA, *Report 338, Accrual Accounting—A Cultural Change*, AGPS, Canberra 1995, p. 39.

<sup>6</sup> JCPA, *Report 341 Financial Reporting for the Commonwealth: Towards Greater Transparency and Accountability*, AGPS, Canberra, 1995.

<sup>7</sup> JCPA, *Report 341*, Recommendation 5, p. 47.

#### *Asset management audits*

1.9 Recent Government financial and administrative reforms have resulted in a new financial management and budgeting framework for Commonwealth agencies being put in place, together with accrual appropriation and whole of government reporting for the 1999–2000 financial year. Accrual budgeting will increase pressure on Commonwealth agencies to improve the management of the assets they control.

1.10 As part of the preparations for this development, the ANAO undertook in 1996 an audit of asset management in twenty-four Commonwealth agencies.

1.11 The ANAO's objective was to follow up an earlier Management Advisory Board and the Management Improvement Advisory Committee report on asset management.<sup>8</sup> The audit reviewed the current management of non-current physical assets, categorised as property, plant and equipment to determine the capacity of Commonwealth agencies to produce better outcomes.

1.12 As a result of the audit the ANAO developed the *Asset Management Handbook*, the purpose of which was to help asset managers interpret and implement better asset management principles identified in the audit report.<sup>9</sup>

1.13 In late September 1997, the ANAO undertook the first of a two-phase review of asset management arrangements in Commonwealth agencies. The first phase comprised a survey of twenty-five representative Commonwealth agencies to establish the degree of acceptance and the extent of implementation of the recommendations contained in *Audit Report No. 27, 1995–96, Financial Control and Administration Audit, Asset Management*.

<sup>8</sup> Management Advisory Board and the Management Improvement Advisory Committee, *Improving Asset Management in the Public Sector*, AGPS, Canberra 1991.

<sup>9</sup> Auditor-General, *Audit Report No. 27, 1995–96, Financial Control and Administration Audit, Asset Management*, AGPS, Canberra 1996, pp. 21–6.

1.14 The second phase involved testing at a small number of agencies to determine the extent to which its asset management principles had been adopted. The results were tabled in Parliament in April 1998 as *Audit Report No. 41, 1997-98, Financial Control and Administration Audit, Asset Management*.

### The Committee's inquiry

1.15 In August 1996 the JCPA revisited asset management issues when it reviewed *Audit Report No. 27, 1995-96*. In the subsequent report of the review—*Report 349*—the JCPA called on the Government to finalise its response to *Report 341* and clarify its intentions concerning financial management reform and the promotion of better asset management in Commonwealth agencies.<sup>10</sup>

1.16 The JCPA received the Government's response to *Report 341* in early 1997. The response indicated that the newly developed asset valuation guidelines for government business enterprises contained appropriate methodologies for valuing assets. However, significant work remained to be completed in several areas and these issues would be addressed as part of the Commonwealth's move to a full accrual financial management and budgeting framework.

1.17 The now Joint Committee of Public Accounts and Audit<sup>11</sup> has maintained its interest in asset management and during 1997 was advised by the Auditor-General that he was about to undertake a follow-up of the findings in *Audit Report No. 27, 1995-96*. As a result the Committee decided to undertake a review of asset management by Commonwealth agencies and adopted terms of reference in September 1997.

10 JCPA, *Report 349, Review of Auditor-General's Reports 1995-96*, AGPS, Canberra, 1997, Recommendation 5, p. 38.

11 On 1 January 1998, following amendment to the Public Accounts Committee Act 1951, the JCPA became the Joint Committee of Public Accounts and Audit.

1.18 The findings of the preliminary follow-up survey undertaken by the ANAO were used by the Committee as background for this present review. The results of the follow-up survey are also discussed in *Audit Report No. 41, 1997-98* which was tabled just prior to the Committee's public hearing.

### Conduct of the inquiry

1.19 Invitations to provide submissions to the inquiry were sent to the agencies that had been involved in ANAO's follow up survey and to various private sector accounting firms. A list of the submissions received by the Committee can be found at Appendix I and a list of exhibits at Appendix II.

1.20 The Committee subsequently held a public hearing on 20 April 1998. A list of participants at the hearings can be found at Appendix III.

### Structure of this report

1.21 Chapter 2 of this report continues a brief description of the proposed accrual based financial management and budgeting framework for Commonwealth agencies; what is needed for agencies to adopt the framework; and how change may be facilitated.

1.22 Chapter 3 discusses the performance of Commonwealth agencies in currently managing their assets; the change in culture that is needed to improve asset management; and how this change may be encouraged.

1.23 The report concludes, in Chapter 4, with comments on the potential for greater efficiencies in the management of the Commonwealth's assets.

**Further information**

1.24 Further information about the Joint Committee of Public Accounts and Audit, transcripts of the public hearing, and the text of this report can be found on the home pages of the Committee on the world wide web.<sup>12</sup>

12 The JCPAA's world wide web address is  
<http://www.aph.gov.au/house/committe/jpaa/>

**2****THE NEW FRAMEWORK****Introduction**

2.1 This chapter provides a brief outline of the accrual based management framework being introduced for Commonwealth agencies. This new framework will have implications for asset management practices within Commonwealth agencies. A discussion of the role of central agencies in providing guidance to facilitate the transition to the new environment forms the final section of the chapter.

**Accrual based management framework**

2.2 In evidence to the Committee, Mr Graham Millar, Financial Framework Branch, Department of Finance and Administration (DoFA), said that the Government had taken a three-pronged approach to creating the appropriate framework for asset management by:

- allocating assets 'to managers that have a specialist role, or indeed, a commercially driven role';
- establishing 'an appropriate financial management framework that involves the chief executive of agencies having the responsibility and the accountability to manage the agency's assets'; and
- introducing accrual reporting and accrual budgeting.<sup>1</sup>

2.3 It is the second and third points which are of interest to this inquiry and form the subject of the following sections.

1 DoFA, *Transcript*, pp. 64-5.

*Financial Management and Accountability Act 1997*

2.4 The Financial Management and Accountability (FMA) Act requires all Chief Executives to promote the effective, efficient and ethical use of the Commonwealth resources for which they are responsible.<sup>2</sup>

2.5 The then JCPA reviewed this clause in the legislation when the Bill was referred to the Committee in June 1994. The present Committee agrees with the previous Committee that this clause is 'a particularly important provision'<sup>3</sup> because it confirms that Chief Executives are accountable in law for the resources their agencies manage.

2.6 The primary vehicle for implementing the rules and procedures and assigning responsibility for matters covered by the FMA Act are the Chief Executive Instructions issued by each agency. Asset and property management are included in the responsibilities covered by these instructions.<sup>4</sup>

*Accrual reporting*

2.7 Accrual-based reporting has been mandatory for all Commonwealth agencies since the 1994-95 financial year. A fundamental feature of the system is that where an item will continue to provide benefit to an agency beyond the current reporting period, the accrual system records that item as an asset, and requires it to be depreciated over the period of consumption of its value.<sup>5</sup> The accrual system for financial reporting has therefore increased the focus on agency asset holdings.

2 *Financial Management and Accountability Act 1997*, Section 44 (1), p. 30.

3 JCPA, *Report 331, An Advisory Report on the Financial Management and Accountability Bill 1994, the Commonwealth Authorities and Companies Bill 1994 and the Auditor-General's Bill 1994, and on a Proposal to Establish an Audit Committee of Parliament*, AGPS, Canberra, 1994, p. 14.

4 DoFA, *Submission*, p. S44.

5 This contrasts with the cash system where an asset is only recorded as a cash outflow in the year of purchase, and thereafter disappears from financial reports. DoFA, *Submission*, p. S46.

2.8 Financial reporting was refined further with the preparation of accrual-based whole of Commonwealth Government financial statements for 1996-97. Such statements provide 'a better basis for strategic analysis of the Commonwealth's assets'.<sup>6</sup>

2.9 To assist agencies in preparing financial statements, the Minister for Finance in 1997 issued *Guidelines for Financial Statements of Commonwealth Departments* and *Guidelines for Financial Statements of Commonwealth Authorities*.

2.10 Departments and authorities are now required by 1 July 1999 to progressively value all departmental and administered assets able to be reliably measured and material in value or name, in accordance with the 'deprival' method,<sup>7</sup> and revalue progressively on that basis every three years.<sup>8</sup>

2.11 To further assist agencies, DoFA is developing guidelines for the valuation of depreciable assets in the general government sector. An exposure draft was released in April 1998.<sup>9</sup>

2.12 Commenting on the effectiveness of these developments, Mr Edward Hay, Business Assurance Services Group, ANAO, told the Committee, 'It is fine to have reasonably effective accounting systems that record the valuation of assets', but that:

... the real value will come when agencies, program managers and CEOs are asking themselves these questions: *Why do we have these assets? What are these assets contributing to our program outcomes? Are they contributing? If not, why do we have them?*<sup>10</sup>

6 DoFA, *Submission*, p. S46.

7 The deprival method identifies the appropriate method of valuing an asset having regard to the nature of the asset and the circumstances of the controlling entity. The entity has to consider its actions as if it were deprived of the asset. If circumstances indicated that the asset would not be replaced, then it would be valued at its current market selling price. If the asset were to be replaced it would be valued at the price of a suitable replacement, Exhibit 2, pp. 3-5.

8 DoFA, *Submission*, p. S47.

9 Exhibit 2, *Asset Valuation Guidelines, Exposure Draft*, DoFA, 1998.

10 ANAO, *Transcript*, pp. 6-7.

2.13 A similar view was put by Mr Mike Darcy, Accrual Budgeting Project, DoFA, who told the Committee that the current reporting requirements had not necessarily improved asset management because 'there were no broad incentives in the framework to make sure that people looked at asset management in particular.'<sup>11</sup>

2.14 As an example, the current funding arrangements do not encourage 'a consistent approach to life-cycle cost analyses and operating cost implications are not consistently reported.' The submission from DoFA stated that the new accrual budgeting framework would address those weaknesses.<sup>12</sup>

#### *Accrual budgeting*

2.15 Following consideration and recommendation by the National Commission of Audit,<sup>13</sup> the Government in April 1997 decided to implement an accrual-based outcomes and outputs framework for the Commonwealth. For the financial year 1998-99 accrual budgets will be produced for a trial group of agencies after the current cash-based budget has been brought down. For the 1999-2000 financial year accrual budgeting will be implemented for all agencies.<sup>14</sup>

2.16 In its submission, DoFA stated that it expected accrual-based budgeting would, 'through ongoing incentives, or sanctions, require managers to actively manage their total resource base.'<sup>15</sup> More specifically, it would:

11 DoFA, *Transcript*, p. 68.

12 DoFA, *Submission*, p. S48.

13 National Commission of Audit, *Report to the Commonwealth Government*, AGPS, June 1996, pp. 235-7.

14 DoFA, *Accrual Budgeting Project, Exposure Draft, Specification of Outcomes and Outputs*, pp. 1, 6.

15 DoFA, *Submission*, p. S48.

... require agencies to specify what they produce with departmental resources. They will be required to define outputs and link them to outcomes. The Commonwealth will pay a price for those outputs, such price being set having regard to market prices where similar services are provided, or alternatively benchmarked against other government jurisdictions providing similar services.<sup>16</sup>

2.17 Agencies would thus prepare budgets which detailed the full costs of the outputs produced, and would be funded against the cost of those outputs. This funding would include provision for asset depreciation and Comcover insurance.<sup>17,18</sup>

2.18 Agency funding could also be supplemented for a capital use charge if one were introduced.<sup>19</sup> The potential benefits of the introduction of a capital use charge is discussed in Chapter 4.

2.19 Poor management at agency level would be reflected by the price of outputs being higher than necessary or through the generation of an operating loss if costs exceeded revenue.<sup>20</sup>

#### **Impact of the new framework**

2.20 Agencies varied in their assessment of the impact of the new framework on their management of assets.

16 DoFA, *Submission*, pp. S48-9.

17 DFAT, *Submission*, p. S38; Exhibit 8, *Comcover: An introduction to the Commonwealth's new insurable risk managed fund*, DoFA, p. 3.

18 From 1 July 1998 an insurable risk managed fund, Comcover, will replace the Commonwealth's previous non-insurance policy. All General Government Sector agencies will be required to pay an annual premium, based on their agreed excess, liability exposures, and claim records. Where appropriate, agencies will be supplemented for their premiums.

19 DoFA, *Submission*, p. S49.

20 DoFA, *Submission*, p. S49.

2.21 The Joint House Department commented that the new framework should not have an impact on management because a commercial and accountable approach should continue. There would be an impact on the way asset purchases or replacements were funded.<sup>21</sup>

2.22 Comcare suggested that the new framework may initially create problems for the agencies which needed to upgrade their systems, and that agencies will need to 'focus on all aspects of asset management, rather than focussing on the process.' The ultimate effect should be to move towards best practice.<sup>22</sup>

2.23 The Committee agrees that if agencies are to meet the demands of the new accrual-based framework, best practice principles for asset management will need to be implemented. Such principles are outlined in ANAO's *Asset Management Handbook* as:

- asset management decisions are **integrated** with strategic planning;
- asset planning decisions are based on an evaluation of **alternatives** which consider the '**life-cycle**' costs, benefits and risks of ownership;
- **accountability** is established for asset condition, use and performance;
- disposal decisions are based on **analysis** of the methods which achieve the best available net return within a framework of fair trading; and
- an effective **control structure** is established for asset management.<sup>23</sup>

2.24 In order to achieve these principles, relevant specific practices are required. Some of these are discussed below.

21 JHD, *Submission*, p. S71.

22 Comcare, *Submission*, p. S14.

23 ANAO, *Asset Management Handbook*, p. 10.

#### *Integration with other management processes*

2.25 An important component of asset management is the integration of asset planning with other strategic management processes.<sup>24</sup>

2.26 For example there need to be linkages with specialist staff recruitment and training, engineering service or maintenance, and information technology or other support. Program managers should therefore ensure that staff in charge of these components are aware of asset management issues.

2.27 Asset management needs to be focused upon at the highest levels within agencies; the need for the involvement of the Chief Executive Officer as a means to promoting a cultural change in the management of assets is discussed in Chapter 3.

#### *Assessment of alternatives to asset ownership*

2.28 While assets may be necessary to deliver programs, it is not essential that an agency own them. Outsourcing to the private sector for service delivery is one way of reducing asset holdings. Others include redesigning the service delivery strategies, moderating the demand for programs, or re-allocating resources internally.<sup>25</sup>

2.29 If assets are to be purchased, the principal choice is between leasing or buying. Leasing also presents a choice between 'operating' and 'finance' leases. Life-cycle costing calculations, and considerations including frequency of use, flexibility requirements, specialised features, and security, impact on the decision between purchase, lease, or a 'non-asset' alternative.<sup>26</sup> This issue is discussed further in Chapter 4.

24 ANAO, *Asset Management Handbook*, pp. 28-30; Domain Consulting, *Submission*, p. S33.

25 ANAO, *Asset Management Handbook*, pp. 32-3.

26 ANAO, *Asset Management Handbook*, pp. 32-3.



*Fully costed outputs and outcomes*

2.30 Assets are held in order to achieve program outcomes. It is therefore important that assets be aligned to an agency's programs to the extent practicable, allowing the full cost of program delivery to be more readily determined.<sup>27</sup>

2.31 The Committee considers that the increased emphasis on market comparisons and benchmarking for program outcomes, and in many areas competitive tendering for funding and service provision, will require accurate costings. Agencies can neither afford to underestimate the price required for their services, nor to over estimate their costs and render themselves uncompetitive.

2.32 Complications will arise if the optimum use of assets is achieved through sharing arrangements with other programs or with other agencies. This will require a sophisticated system to accurately record and apportion costs.

*Full life-cycle costing*

2.33 Asset life-cycle costing is the total cost of owning the asset, including both capital and recurring costs, over the estimated period of time it is expected to be of use to the agency. Design, construction, maintenance, insurance, refurbishment, operating and disposal costs are all included. A purchasing decision based on the lowest initial capital price but which ignores potential differences in operating costs, may result in a higher total cost over the asset's life.<sup>28</sup>

2.34 Life-cycle costing also provides benefits by setting a baseline and targets for performance and maintenance over the asset's life. Accurate monitoring and feedback will enable future management or procurement decisions to be more effective. Life-cycle costing also accommodates timely and effective disposal strategies, and better preparation for replacing the asset.

27 ANAO, *Asset Management Handbook*, p. 30.

28 ANAO, *Asset Management Handbook*, pp. 3, 63.

*Correct on-going valuation of assets*

2.35 An asset is usually valued, at the time of acquisition or recognition, 'at cost'. Where it is donated or transferred, a 'fair value' is determined. However, because that initial cost becomes less relevant over time, assets need to be revalued regularly.

2.36 The ANAO's *Asset Management Handbook* recommends that revaluation be undertaken by experts, either from an independent organisation such as the Australian Valuation Office, or agency staff with appropriate specialist expertise.<sup>29</sup> As stated above, the DoFA *Guidelines* require that from 1999 agencies revalue assets, using the deprival method, every three years, and DoFA has provided further advice on asset valuation methods.<sup>30</sup>

2.37 Although one valuation method may be required for accounting purposes, the submission from Dr Penny Burns, Director, AMQ International, argued that agencies should be prepared to obtain a variety of values for an asset. This was because sound asset management decisions can result from comparisons between different values.<sup>31</sup>

*Appropriate depreciation regimes*

2.38 Cash accounting shows asset purchases as expenditure in the year in which payment is made. This overstates program costs in that year as it fails to reflect the fact that the asset is used over a number of years. Accordingly the cost of the asset should be spread over that period. Accrual accounting, and in particular the process of depreciation, allow the actual cost of programs to be seen, as and when the asset's service potential is consumed.<sup>32</sup>

29 ANAO, *Asset Management Handbook*, pp. 55-6.

30 Exhibit 2, *Asset Valuation Guidelines, Exposure Draft*, DoFA, 1998.

31 AMQ International, *Submission*, p. S29.

32 ANAO, *Asset Management Handbook*, p. 57.

2.39 Depreciation is calculated by allocating the asset value over the useful life of the asset. This estimate is based on 'normal' maintenance being undertaken as required. It is therefore only partly a reflection of the 'wearing out' of the asset, and is not a process of saving up for new assets. It may also be necessary to make a 'provision for major maintenance' depreciation deduction, in addition to the normal depreciation provision.<sup>33</sup>

2.40 The relationship between a depreciation regime and the value of an asset is not simple. Mr David Hope, appearing on behalf of the Australian Society of Certified Practising Accountants (ASCPAs), told the Committee that:

*When you come to sell off an asset, often the depreciated value and the market value are very different. I think that will always be the case while we continue to have straight-line depreciation ... because assets do not depreciate in a straight line.*<sup>34</sup>

2.41 Depreciation is important for accounting accuracy, but also for its wider management implications, such as deciding when to dispose of an asset. Mr Andrew Greaves, Business Assurance Services Group, ANAO, commented, 'the bottom line is that, if the depreciation charge is wrong, then [agencies] will be making [incorrect] decisions based on that information.'<sup>35</sup>

### **Facilitating change in Commonwealth asset management**

#### *Central guidance to agencies*

2.42 Central policy guidelines with respect to asset management are contained in ANAO's *Asset Management Handbook* and DoFA's *Asset Valuation Guidelines*. The question for the Committee is whether such guidance is sufficient.

33 ANAO, *Asset Management Handbook*, p. 57.

34 ASCPAs, *Transcript*, pp. 19-20.

35 ANAO, *Transcript*, p. 8.

2.43 Most witnesses supported the provision of central guidance (for example, from DoFA) but expressed reservations about certain implementation strategies, degrees of control, or applicability to their agency.

2.44 Mr Robert Tonkin, Deputy Secretary Corporate, Department of Defence (Defence), argued that central involvement would be of little value for their specific military assets, since the experts in the field of valuing or managing those assets are Defence staff.<sup>36</sup> Nonetheless, Mr Edward Hay, ANAO, stated that state experiences suggested that 'you can provide strategic management guidance at a central level without interfering with the specialist managers' asset management role.'<sup>37</sup>

2.45 The ASCPAs supported central guidance 'at the policy level', so long as it is not 'too prescriptive'.<sup>38</sup> Mr Graham O'Loughlin, Coopers and Lybrand, pointed out that most states have, and gain benefit from, a central guidance unit. The Commonwealth also has central units for competitive tendering and contracting.<sup>39</sup> Ms Diane Fielding, National Manager Finance, Centrelink, stated they 'would certainly welcome some higher level policy advice', but hoped the central unit would focus on outcomes not process, and 'say to us, "This is what we expect you to achieve," rather than, "This is how we expect you to do it".'<sup>40</sup> Comcare also supported 'clear, unambiguous guidelines', and along with several agencies identified a need to 'ensure that the guidelines are applied consistently throughout the public sector'.<sup>41</sup>

2.46 The Committee has received a copy of the guidance provided in 1995 to Victorian Government agencies by the Victorian Department of Treasury and Finance. This is a highly prescriptive document as indicated by the following comments relating to asset management principles:

36 Defence, *Transcript*, p. 46.

37 ANAO, *Transcript*, p. 13.

38 ASCPAs, *Transcript*, p. 19.

39 Coopers and Lybrand, *Transcript*, p. 23.

40 Centrelink, *Transcript*, p. 51.

41 Comcare, *Submission*, p. S15 (emphasis added).

*Agencies are to undertake asset management activities within a strategic framework that is driven by program and service delivery needs. ... Planning, budgeting for, and reporting on assets are to be integrated with broader planning processes, both within agencies and between central and other agencies. ... The asset management checklist at the end of this part provides more details of the requirements for implementing these principles.<sup>42</sup>*

2.47 Such a prescriptive approach contrasts with the style of the *Asset Management Handbook* produced by the ANAO. The Preface advises that the handbook 'will help asset managers interpret and implement' asset management principles which were 'not definitive but are consistent with current thinking on, and trends in, improving asset management in the public sector.'<sup>43</sup>

#### *The Committee's conclusion*

2.48 There is a policy expectation indicated by the Minister's *Guidelines for Financial Statements* that Commonwealth departments and authorities use the deprival method for valuing assets to ensure consistency between Commonwealth agencies:

*Property, plant and equipment must be progressively valued in accordance with the 'deprival' method of valuation ... by 1 July 1999 then revalued progressively on that basis every three years.<sup>44</sup>*

2.49 As a consequence, DoFA's *Asset Valuation Guidelines* have been issued, albeit currently only in exposure draft form to provide guidance to agencies.

42 Exhibit 9, *Asset Management Series, Principles, Policies and Practices, Catalogue of Reference*, Victorian Department of Treasury and Finance, 1995, p. 1.5.

43 ANAO, *Asset Management Handbook*, Preface.

44 Department of Finance, *Financial Statements of Commonwealth Authorities—Guidelines issued by the honourable John Fahey Minister for Finance*, July 1997, p. 7.

2.50 Apart from the valuation methodology, there is no specific policy requirement for particular asset management techniques to be used. To issue such requirements, given the diverse nature of Commonwealth agencies would be inappropriate. Indeed evidence to the Committee indicates such a course would not be welcomed by agencies.

2.51 There are a number of methodologies to assist agencies achieve efficient management of their assets, but there is no one correct method. This is acknowledged in the Preface to ANAO's handbook.

2.52 The Auditor-General's role extends to assessing the effectiveness of the performance of agencies in achieving their aims. In so doing the Auditor-General has a view of what constitutes best practice.

2.53 The Committee considers that ANAO's *Asset Management Handbook* is an excellent guide for asset management and should be used by agencies to assist them formulating their own procedures tailored to their particular circumstances.

2.54 Consequently, the Committee concludes that, given the diverse and devolved nature of the Commonwealth public sector, an appropriate level of guidance has been given for asset management.

#### **Best practice models**

2.55 In his submission to the Committee, Mr Wayne Edgton, Director, Domain Consulting recommended that a small number of agencies should be selected as pilots to establish a best practice asset management framework. Other agencies could then model their asset management on that best practice.<sup>45</sup>

2.56 The Committee notes that this strategy was used for the trial of accrual reporting and is being used for the introduction of full accrual budgeting.

45 Domain Consulting, *Submission*, p. S35.

2.57 It is apparent to the Committee that some agencies have already implemented better practice asset management strategies, and it would be of value for these agencies to share with others the knowledge and skills they have gained. There would thus be value in the creation of an asset management forum, at which agencies could exchange information on a regular basis.

2.58 Given the policy role of DoFA in providing guidance for asset valuation and ANAO's provision of broader asset management guidance, the Committee believes that both agencies should have a role in establishing an asset management forum.

2.59 **Recommendation 1**

*The Department of Finance and Administration and the Australian National Audit Office should jointly convene an Asset Management Forum. The Forum should comprise interested Commonwealth agencies and should meet regularly, provided the need exists, to exchange information on asset management issues.*



## THE MANAGEMENT OF ASSETS

### Introduction

3.1 This chapter focuses on the current performance of agencies managing Commonwealth assets in the light of the requirements of the new accrual accounting environment, and changes which may be required to improve performance.

3.2 The Auditor-General has reviewed the performance of Commonwealth agencies and has published two audit reports and an asset management handbook.

3.3 The first audit report, tabled in 1996, was reviewed by the Committee in late 1997.<sup>1</sup> During this inquiry, many of the issues discussed by both audit reports were raised in submissions and at the public hearing. While it is necessary to draw attention to these matters, the Committee believes that it is more important to focus on improving agencies' corporate approach to their asset management responsibilities.

### The performance of agencies in managing assets

*Audit Report No. 27 1995-96, Financial Control and Administration Audit, Asset Management*

3.4 On 14 June 1996, the Auditor-General tabled *Audit Report No. 27, 1995-96, Financial Control and Administration Audit, Asset Management*. The objectives of the audit were to

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<sup>1</sup> The Committee tabled its findings in *Report 349, Review of Auditor-General's Reports 1995-96*, pp. 33-8.

assess how well agencies were managing their assets to produce better outcomes, and to identify or develop better practice in asset management.

3.5 The audit concentrated on the Commonwealth's non-current physical assets, categorised as property, plant and equipment, and focussed on the general government sector (as opposed to government business enterprises or defence related assets).

3.6 The audit highlighted many areas for potential reform in the way that Commonwealth agencies manage the physical assets they control and included a better practice guide to asset management. The audit report was accompanied by the release of an asset management handbook.<sup>2</sup>

3.7 The areas for improvement identified in *Audit Report No. 27, 1995-96* match closely those raised in submissions and by witnesses as being necessary if agencies are to successfully meet the demands of the new accrual based management framework. These have been discussed in Chapter 2.

3.8 The Auditor-General's recommendations included the need for agencies to review:

- their current approach to asset management by comparing their practices and procedures with the asset management principles outlined in the audit report; and
- the need for a structured training program to address the skills required at the management and operations levels with particular emphasis on program managers.<sup>3</sup>

2 ANAO, *Asset Management Handbook*, ANAO, 1996.

3 Auditor-General, *Audit Report No. 27, 1995-96, Financial Control and Administration Audit, Asset Management*, pp. 4-5.

3.9 The aim of ANAO's *Asset Management Handbook*, released with the audit report, was to assist managers in their interpretation and implementation of ANAO's asset management principles. The handbook provided information on:

- management control—the policies, procedures, and management information required to make timely, informed asset management decisions;
- integrated planning—the integration of each of the elements of asset management with the agency's program delivery objectives and strategies;
- acquisition decisions—the use of life-cycle costing to determine whether to buy or lease particular assets;
- operations—the establishment of effective accountability mechanisms to ensure that the use and maintenance of assets remain relevant to program delivery;
- disposal—consideration of alternatives to disposal and the methods of disposal; and
- accounting and valuation—the recording and valuation of assets and the allocation of asset values throughout their use.

#### *Audit Report No. 41, 1997-98, Asset Management*

3.10 In late 1997, the Auditor-General commenced a follow up audit to ascertain the degree of acceptance of the recommendations of *Audit Report No. 27, 1995-96* and to establish the extent to which agencies were managing their assets in accordance with the principles outlined in the *Asset Management Handbook*. The findings were tabled in April 1998 as *Audit Report No. 41, Financial Control and Administration Audit, Asset Management*.

3.11 The Auditor-General found that while there had been general acceptance of the recommendations arising from the previous audit, a significant number of agencies had yet to implement the recommendations. Specifically, many agencies had yet to :

- adopt strategic approaches by effectively integrating asset planning decisions into corporate and resource planning frameworks;
- formalise and systematically analyse whole of life cost in major asset acquisition, operational use or divestment decisions;
- establish baseline cost and performance standards for key assets;
- implement financial management and asset management systems which capture adequate asset related information; and
- integrate disposal decisions into a framework which monitors the outcome of the disposal process.<sup>4</sup>

3.12 The Auditor-General's opinion was that:

*... effective strategic asset management remains a challenge for many government organisations.*

*While the gap between what has been achieved and best practice has narrowed in the past two years, particularly for 'core' government organisations, more will need to be done with the introduction of accrual budgeting, a capital charge [which is being considered] and the new centrally-based insurance arrangements.<sup>5</sup>*

#### *The Committee's conclusion*

3.13 There are some 150 organisations within the general government sector covered by the *Financial Management and Accountability Act 1997* and the *Commonwealth Authorities and Companies Act 1997*.<sup>6</sup> Twenty four of these organisations were the subject of *Audit Report No. 27 1995-96*.<sup>7</sup>

<sup>4</sup> Auditor-General, *Audit Report No. 41, 1997-98, Financial Control and Administration Audit, Asset Management*, pp. 3-4.

<sup>5</sup> Auditor-General, *Audit Report No. 41, 1997-98*, p. 3.

<sup>6</sup> Exhibit 8, p. 3.

<sup>7</sup> Auditor-General, *Audit Report No. 27, 1995-96*, p. 27.

3.14 The follow up audit involved a survey of twenty five organisations most of which were not covered earlier. The sample was intended to be representative of the government sector and 'included departments, agencies, departmental commercial undertakings and statutory authorities.' Six of these agencies were subject to an in-depth audit.<sup>8</sup>

3.15 The Committee considers that the audits conducted by the Auditor-General have provided a representative sample of current practice and that the findings presented fairly represent the situation regarding asset management by Commonwealth agencies.

3.16 In fact, no evidence was presented to the Committee in submissions or at the public hearing to alter the Committee's view that progress in achieving better practice in asset management is patchy.

3.17 The next section discusses what is needed at the agency level to promote better asset management.

## Towards better asset management

### *Introduction*

3.18 Recent moves towards the implementation of accrual accounting and reporting in the public sector have changed management emphasis from process to outputs and outcomes—in other words service delivery. This has involved the coordination of a range of resources, typically:

- human resources;
- consumables;
- information resources (eg corporate memory, intellectual capital); and
- non-financial physical assets (eg buildings, equipment).<sup>9</sup>

<sup>8</sup> Auditor-General, *Audit Report No. 41, 1997-98*, pp. 20-1.

<sup>9</sup> Coopers & Lybrand, *Submission*, p. S67.

3.19 The submission from Mr Graham O'Loghlin, Coopers & Lybrand, observed that:

*... the management of the physical assets generally attracts much less attention than other resources. ... they incur substantial costs, are intrinsic to the cost and quality of services delivered, but are not often subject to the same level of scrutiny. In most agencies the quality of reporting on asset performance is minimal and limited to statutory financial reporting.<sup>10</sup>*

3.20 Evidence presented to the Committee indicated there needs to be a cultural change within agencies beyond the current emphasis on asset recognition as part of accrual accounting and reporting. Such change requires a more strategic approach and the commitment of senior management.

#### *Beyond accrual accounting and reporting*

3.21 The Committee has received evidence from four professional organisations with expertise in asset management that effective asset management requires more than accrual accounting and reporting.

3.22 The submission from Dr Penny Burns, AMQ International, emphasised that accrual accounting is a necessary tool, but that unless care is taken its implementation can be detrimental to good asset management. Three examples were provided:

- The accounting system can encourage under-maintenance of assets—lower maintenance costs will show up in the current year's accounts as reduced costs, but will increase asset degradation and accrue future liabilities. Condition-based depreciation is a solution.
- Asset valuation for reporting purposes can absorb more resources than can be justified in management terms.

<sup>10</sup> Coopers & Lybrand, *Submission*, p. S67.

- Balance sheets record one value for the asset so require the use of one valuation method—replacement, insurance, historic and various 'market' values are all useful. However, comparisons are needed for management decisions. For example, a comparison of 'value in current use' with the 'value at highest and best' may indicate an asset is being under-utilised.<sup>11</sup>

3.23 A fourth example was provided by Mr David Hope, ASCPAs, who noted that straight line depreciation, required by accounting standards, was often unrealistic because the value of assets does not decline by the same amount each year, some may actually increase in value as improvements are made, and similar assets in different environments may suffer different rates of deterioration.<sup>12</sup>

3.24 Typical asset management policies and practices focus on accounting-based issues. The submission from Mr Wayne Edgton, Domain Consulting, noted that the focus was on identifying, valuing, stocktaking, depreciating and disposing of assets, but broader focus was required, such as:

- justifying capital expenditure, including linkages to service strategies and life cycle implications;
- consideration of alternatives to acquiring assets;
- how assets were to be maintained; and
- promoting disposal of under utilised assets.<sup>13</sup>

3.25 A similar view, the need for broader information than that required for accrual accounting purposes, was provided by Mr Graham O'Loghlin:

<sup>11</sup> AMQ International, *Submission*, pp. S27-9.

<sup>12</sup> Exhibit 7, *Transcript of Committee briefing by the Australian Society of Certified Practising Accountants, 2 April 1998*, pp. 3, 5.

<sup>13</sup> Domain Consulting, *Submission*, p. S33.

*There seems to be a sentiment running through the debate that asset management is primarily an accounting matter ... We believe that such an approach is misleading, and that financial information alone is not adequate to make decisions about assets.<sup>14</sup>*

3.26 In addition to financial information, there needed to be data on:

- *Physical condition (compliance with codes, extent of any maintenance "backlog", future obligations for major refurbishment, etc);*
- *Utilisation—intensity of use, ranging from "unused, or sporadic use" to "very intense" (ie overloaded—may need extra capacity); and*
- *Functionality or fitness for purpose. How well does the asset fulfil the purpose for which it is being used?<sup>15</sup>*

3.27 The views outlined above were also expressed by representatives of the ASCPAs, Mr David Hope and Mr Kevin Lewis.<sup>16</sup> They commented that currently 'assets are being driven by the accounting side of things and not by the people who actually use the assets.' This needed to change 'because of the huge investment that there is in assets.' They concluded that the principle of accruals-based asset management was that it 'is taken out of the hands of the accountants. They are just a role player, and the line managers are the ones that have control of the assets.'<sup>17</sup>

#### *A more strategic approach to asset management*

3.28 As part of the follow-up audit, the Auditor-General tested whether agencies had linked their asset management into the strategic planning processes of the organisation, for example with corporate and program objectives, and service delivery strategies and standards.

14 Coopers & Lybrand. *Submission*, p. S83.

15 Coopers & Lybrand. *Submission*, p. S83.

16 Exhibit 7, p. 13.

17 Exhibit 7, pp. 7-8.

3.29 The audit found that the majority of the twenty five agencies surveyed had yet to integrate effectively asset decisions into their strategic planning processes. In addition, where funding of acquisitions had been devolved to program level, there was no evidence that there had been consideration of the best alignment of assets to functional needs.<sup>18</sup>

3.30 The Auditor-General consequently recommended that agencies develop an appropriate asset strategy for all key assets. The strategy should:

*... coincide, and be integrated, with major corporate and business planning arrangements. ... [and] address the impact of any known or proposed changes to service delivery strategies or program objectives arising from government policy initiatives, the competitive tendering and contracting regime, technical advancements and other relevant developments or issues.<sup>19</sup>*

3.31 Mr Edgtton told the Committee that a cultural change was needed and required integration of the accountants with other parts of the organisation—'senior management, engineers if they are looking after buildings, IT managers, et cetera.' This task, in his experience, took many years.<sup>20</sup>

3.32 Mr Hope emphasised the need for a corporate perspective:

*Managing assets is a corporate activity. That is the most important thing I could say. It is not the role of the people who are physically managing the assets; it is not the role of the bean counters. It has to have a corporate perspective and, if it does not ... whatever the organisation does it is probably not going to be fully effective.<sup>21</sup>*

18 Auditor-General, *Audit Report No. 41, 1997-98*, p. 9.

19 Auditor-General, *Audit Report No. 41, 1997-98*, pp. 10-11.

20 Domain Consulting, *Transcript*, p. 27.

21 Exhibit 7, p. 14.



3.33 Witnesses from the ANAO and representatives from the ASCPAs were also in agreement that the required cultural change had to be driven from the top and that the CEO and program managers needed to see asset management as good business sense.<sup>22</sup>

3.34 Mr Edgton went further and suggested that 'funding should be at least in part dependant on asset management performance',<sup>23</sup> and Mr Hope advocated ensuring CEOs have 'an explicit role in managing the assets, and that they are held accountable for that, and that it is part of the measurement of their performance as a CEO.'<sup>24</sup>

3.35 On a positive note, the fact that agencies are responding to the challenge of better asset management by taking a more strategic approach was provided by evidence from the Department of Health and Family Services (DHFS). DHFS advised that:

- its managers would soon have to 'incorporate asset management plans within their program business planning processes';
- DHFS's 'Chief Executive Instructions and Procedural Rules [were] being tailored to meet both strategic and operational requirements'; and
- staff would have to 'consider the financial consequences of all aspects of asset management from their acquisition to their eventual disposal.'<sup>25</sup>

#### *The Committee's conclusion*

3.36 The Committee considers that, while the current move to accrual-based reporting and budgeting has improved the recognition of assets, financial information alone is insufficient for effective asset management. More information about assets needs to be collected by agencies and an integrated strategic approach has to be adopted.

22 ANAO, *Transcript*, p. 12; Exhibit 7, pp. 7, 9–10, 13.

23 Domain Consulting, *Submission*, p. S35.

24 Exhibit 7, p. 9.

25 DHFS, *Submission*, p. S75.

3.37 When the Committee inquired into the merits of accrual accounting in 1995, the Committee included the words 'cultural change' in the title of its report to signify the challenge the reform would pose for agencies. As with the adoption by agencies of accrual accounting principles, the introduction of best practice in asset management will also require a cultural change. The Committee agrees that this change has to be driven from the top down, that is by senior management's endorsement and promotion of best practice in asset management within agencies.

3.38 The Committee notes the reference to asset management in Section 44 of the *Financial Management and Accountability Act 1997*:

#### *Promoting efficient, effective and ethical use of Commonwealth resources*

*A Chief Executive must manage the affairs of the Agency in a way that promotes proper use of the Commonwealth resources for which the Chief Executive is responsible.*<sup>26</sup>

3.39 This clause alone, in the Committee's view, does not provide sufficient incentive for better asset management.

3.40 The *Commonwealth Authorities and Companies Act 1997* is silent on the role of chief executive officers regarding proper use of resources, but their organisations own their assets and operate in a more commercial environment. These factors are likely to act as a greater spur to efficiency.

3.41 The Committee does not agree with the suggestion, advocated in one submission, that funding should depend on efficient asset management. However, the Committee is of the firm view that efficient and effective asset management should be a key consideration in measuring the performance of CEOs and agency senior management.

3.42 Higher levels of outsourcing and responsibility for CEOs and Senior Executive Service officers in the Australian Public Service place greater emphasis on performance and efficient management of outcomes—including asset management.

26 *Financial Management and Accountability Act 1997*, Section 44 (1).

3.43 The Committee believes that there is merit in the creation of formal performance measures regarding asset management for the senior management of agencies. This should include indicators for the level of utilisation of assets and the output of the agency compared to the value of assets under its control.

3.44 With respect to asset management reporting, the guidelines for agency annual reports do not specify the inclusion of information to demonstrate that agencies have used the assets under their control in an efficient and effective manner.

3.45 The Committee believes that inclusion of such information in annual reports would provide an additional incentive for senior management to implement better asset management.

3.46 **Recommendation 2**

*Measurement of the performance of the senior management, including Chief Executive Officers, of Commonwealth agencies should include reference to how efficiently and effectively assets under their control are managed.*

3.47 **Recommendation 3**

*The annual reporting guidelines for Commonwealth agencies should be amended to require agencies to provide information indicating how efficiently and effectively agency-controlled assets have been managed.*

## 4

### THE POTENTIAL FOR GREATER EFFICIENCIES

#### Introduction

1.1 This chapter discusses the potential for the introduction of greater efficiencies in the way assets are managed during each of the three phases of their life cycle—acquisition, operation, and disposal. The chapter concludes with an indication of the actual financial benefit to agencies and the Commonwealth that could result from improved asset management.

1.2 The Committee observes that for many activities of government, reviewers turn to the private sector for examples of better practice. However, evidence provided to the Committee suggests that the private sector does not necessarily provide appropriate benchmarks for public sector asset management.<sup>1</sup>

1.3 The Victorian jurisdiction has been suggested as a leader in public sector asset management practice. Evidence, in the form of the asset management guidance provided to agencies in the Victorian jurisdiction was received from the Victorian Department of Treasury and Finance.<sup>2</sup>

1.1 The discussion that follows reflects the majority of the evidence the Committee received during its review which was from asset management consultants and Commonwealth agencies.

<sup>1</sup> AMQ International, *Submission*, p. S30.

<sup>2</sup> Exhibit 9, *Asset Management Series, Principles, Policies and Practices, Catalogue of Reference*, Victorian Department of Treasury and Finance, 1995.

### Acquisition of assets

4.5 The ANAO's *Asset Management Handbook* details the appropriate planning which is needed before assets are purchased. This includes the identification of the costs associated with the asset throughout its useful life and whether there are alternatives to asset ownership.<sup>3</sup>

4.6 Accrual accounting enables managers to identify the full cost of program delivery and assess whether particular aspects, including provision of assets, can more economically be provided by the private sector.

4.7 The commencement of Comcover in July 1998 to provide insurance for the public sector, which includes cover for property damage, will encourage a more critical examination of asset holdings. Managers will have to decide whether the risk should be borne by the agency through the purchase of assets, or whether the risk should be transferred elsewhere by choosing to outsource.

### Ownership of assets

4.8 The submission from Mr O'Loughlin, Coopers & Lybrand suggested it could be argued that the institutional machinery of government does not facilitate effective asset management. Access to quality assets was critical to the functioning of government, but asset ownership was not.

4.9 Mr O'Loughlin suggested consideration should be given to an Australian equivalent of the UK Private Finance Initiative. This allows:

3 ANAO, *Asset Management Handbook*, p. 32.

*... Governments to acquire continuing access to purpose provided assets without owning them. Typically, the Government entity invites bids for 'outputs' ... Bidders then lodge competitive proposals to design, build, finance and operate an appropriate facility ... If and only if the facility is provided to meet the specified performance standards, then the owner/operator is paid an ongoing 'rent'.<sup>4</sup>*

4.10 However, caution on outsourcing was expressed by Mr David Hope, ASCPAs:

*If you have got some core objectives, should you outsource the assets that are associated with them? What sort of control have you lost? You have lost management control. Perhaps the most important thing you have lost when you do outsourcing is that you lose information about what the assets are doing, how they are maintained, et cetera.<sup>5</sup>*

4.11 The Committee received little further evidence on the issue, but observes that the benefits identified by Mr O'Loughlin comprise financial benefits whereas the potential costs identified by Mr Hope are non-financial in nature.

4.12 Care therefore needs to be taken when agencies balance the costs/benefits of outsourcing that both financial and non-financial aspects are fully considered. Evidence outlined in Chapter 3 presented more detailed reasons for taking more than just financial factors into consideration.

### Recognising the cost of capital

4.13 A further aid to fully costing programs would be the recognition of the cost of capital through the introduction of a capital use charge. Although a capital use charge is only being considered by the Government at this stage, the concept generated some debate during the Committee's inquiry.

4 Coopers & Lybrand, *Submission*, pp. S67B-C.

5 Exhibit 7, p. 4.

*A capital use charge*

4.14 A capital use charge is designed to reflect the opportunity cost of capital invested in Commonwealth assets. The advantages of a capital use charge were listed by DoFA as:

- requiring managers to 'include the cost of capital in pricing decisions'—comparisons with other market providers or benchmarking partners would provide incentives to prevent over capitalisation;
- providing an incentive to maintain assets 'in good working order thereby avoiding the need to require further capital funding'; and
- requiring the inclusion of the 'cost of capital in cost/benefit analyses when assessing alternate options for asset acquisition.'<sup>6</sup>

4.15 Witnesses were generally supportive of a capital charge, a major advantage they suggested was the imposition of a discipline on asset managers. However, several witnesses advocated care in the setting of the actual rate that would apply.

4.16 Mr Edgton, Domain Consulting, supported a capital use charge provided it was 'implemented in a simple way.' He suggested it should indicate an approximate cost of capital, rather than the absolute cost, to assist agencies to make informed decisions 'whether to spend money on capital, staffing or on organisational change'. As well, the benefits of those decisions would be made visible.<sup>7</sup>

4.17 Mr Lewincamp, First Assistant Secretary, Resources and Financial Programs, Defence, supported a capital charge—for the discipline it would impose on managers—but considered the rumoured twelve per cent rate to be 'a little high'.<sup>8</sup>

6 DoFA, *Submission*, p. S94.

7 Domain Consulting, *Transcript*, p. 32.

8 Defence, *Transcript*, p. 44.

4.18 Mrs Diana Fielding, National Manager Finance, Centrelink, considered a capital charge made 'a lot of sense' especially in an environment of contestability, but also cautioned that the rate should be appropriate. If the rate was too high, she said:

*... it could lead to some inappropriate decisions in the future, particularly in terms of leasing—decisions may be made to lease assets where, if there were an appropriate charge of capital, the decision may go the other way. ... If the charge of capital starts to devour the bulk of the depreciation that we are getting returned to us as funding, again it could lead to inappropriate decisions in terms of buy or lease.<sup>9</sup>*

4.19 The Committee raised the issue of the capital use charge with witnesses from DoFA. Mr Brett Lennon, Accrual Budgeting Project, advised the Committee that a capital use charge, if introduced, would only apply to net assets under the control of agencies. Administered assets would not attract a charge because agencies could not influence the use of those assets.

4.20 Mr Lennon added that if a rate of twelve per cent was imposed it would be because of the inclusion of a significant risk premium. This would be important if an agency was to compare its output with the equivalent from a private sector operator who faced a capital cost that incorporated such a risk premium. The aim was to create competitive neutrality.<sup>10</sup>

*The Committee's conclusion*

4.21 The Committee supports the decision not to impose a capital use charge, if introduced, on administered assets because this would have created anomalies where the value of such assets is unusually high.<sup>11</sup> The Committee also notes

9 Centrelink, *Transcript*, p. 50.

10 DoFA, *Transcript*, p. 71.

11 The Joint House Department advised that the value of its administered assets amounted to some \$955 million and a capital use charge of 6% would amount to \$57 million or about 1½ times the department's annual budget. JHD, *Submission*, pp. S69, S72.

that many assets, such as some heritage assets, are difficult to value and may qualify as being 'invaluable' in DoFA's draft *Asset Valuation Guidelines*.<sup>12</sup> Such assets would therefore not be able to attract a capital use charge.

4.22 The introduction of a capital use charge would encourage agencies to accurately value their assets and moderate any tendency, when accrual budgeting is introduced, to over value assets to gain advantage of funding to meet asset depreciation.

4.23 The Committee notes that a capital use charge has been operating in New Zealand since the early 1990s. Reports from New Zealand indicate that the charge has been valuable in prompting the disposal of surplus assets and in enabling agencies to set appropriate prices for user charging.

4.24 In concluding, the Committee understands there is considerable ongoing debate within government, at both the Commonwealth and State level, concerning whether a capital use charge should be introduced and the rate at which such a charge should be set.

4.25 **The Committee, consequently, has not made a recommendation on this matter. However, the Committee is of the firm view that a capital use charge, if introduced, could be a valuable tool in promoting better asset management.**

4.26 The inclusion of the cost of capital would assist agencies in arriving at a more realistic budgeted cost for a particular output. As well, accrual accounting would allow agencies to periodically review the actual costs in achieving this output and compare this value with the initial budgeted amount.

4.27 At the end of the accounting year, the 'profit' or 'loss' for the costs associated with a particular output could be particularly revealing to agency management. The Committee therefore considers there would be merit in agencies using this 'variance' analysis for internal management purposes.

12 Exhibit 2, pp. 9, 17.

## Operation of assets

4.28 The issues discussed in the sections above will not only influence whether assets should be acquired, but will also assist in attributing the operational costs of assets to programs. Additional ways of promoting greater efficiency in the operation of assets were raised in evidence—the monitoring of information technology (IT) equipment, and internal charging arrangements.

### *Monitoring information technology equipment*

4.29 The Department of Health and Family Services advised that it was considering the adoption of a system to electronically monitor its IT hardware. This would be via the department's local area network servers. Equipment location and use would be monitored saving stocktaking resources, and identifying assets which were under-utilised.<sup>13</sup>

4.30 A similar system in the Attorney-General's Department is described in ANAO's *Asset Management Handbook*.<sup>14</sup>

### *Internal charging arrangements*

4.31 The Committee received evidence that several agencies have adopted internal charging arrangements to enable managers to recognise the costs associated with asset use, encourage optimum asset use, and the disposal of under-utilised assets. Examples of such arrangements, in place or being contemplated were:

- The Australian Bureau of Statistics in 1989 implemented a user charging regime for IT equipment and support services.<sup>15</sup>

13 DHFS, *Submission*, p. S77.

14 ANAO, *Asset Management Handbook*, p. 61.

15 ANAO, *Asset Management Handbook*, p. 60.

- The Commonwealth Scientific and Industrial Research Organisation has an internal leasing arrangement for occupiers of its buildings. Research managers are able to reduce their lease payments by reducing their usage of facilities and can reallocate the funds freed up for research.<sup>16</sup>
- Defence was reviewing Defence strategic locations and assets were to be consolidated into a Defence Estate Organisation. A notional rental system would probably be introduced.<sup>17</sup>

#### *The Committee's conclusion*

4.32 The initiatives described above provide examples of where managers can be made aware of the true costs associated with their use of assets. The Committee is of the firm view that such innovations must go hand in hand with the promotion of an appropriate culture of strategic asset management within the agency concerned.

4.33 That culture must involve giving managers control of the assets they use to fulfil program objectives, and provide incentives for the more efficient use of assets. Also, the agency must have a policy of reallocating assets so they can be used more effectively elsewhere, or a policy of disposing of surplus assets.

4.34 Without appropriate cultural change, the introduction of innovations designed to promote better asset management may be seen by managers simply as unwelcome impositions.

16 JCPA, *Report 338, Accrual Accounting—A Cultural Change*, p. 119.

17 Defence, *Transcript*, p. 37.

#### **Asset disposal**

4.35 Information on the returns from asset disposal collected by the Auditor-General were presented in *Audit Report No. 41, 1997-98*. This drew the Committee's attention to problems in accounting treatment, with managing assets, or with the methods of disposing of unwanted assets.

4.36 The Auditor-General found that, in financial year 1996-97, the 25 agencies surveyed disposed of assets with a written-down value (ie after depreciation) of \$93 million. However, the proceeds amounted to \$52 million—a book loss of \$41 million,<sup>18</sup> or 44%.

4.37 The Committee explored this discrepancy during the public hearing by seeking information from several agencies relating to their asset disposal performance. The witnesses from the Department of Foreign Affairs and Trade indicated that its disposal of assets with a written down value of \$3 million resulted in a book loss of some 20%.<sup>19</sup> Information from Centrelink showed that the disposal of assets valued at \$1.8 million resulted in a 37% book loss.<sup>20</sup>

4.38 Possible accounting-based reasons for such book losses were:

- the adoption of valuation methods not closely aligned to market value; and
- the adoption of inappropriate depreciation rates.<sup>21</sup>

4.39 Possible management-based reasons were:

- premature sale of an asset resulting from unexpected obsolescence;
- insufficient periodic reviews of the useful lives of assets;

18 Auditor General, *Audit Report No. 41, 1997-98*, p. 12. For the Commonwealth the total book loss from asset sales was \$147 million.

19 DFAT, *Transcript*, pp. 57-8.

20 Centrelink, *Submission*, p. S85.

21 ANAO, *Transcript*, pp. 7-8; DoFA, *Submission*, p. S86.

- insufficient periodic reviews of the amounts expected to be recovered on asset disposal; and
- adoption of approaches to asset disposal which did not achieve best value for the Commonwealth.<sup>22</sup>

4.40 The Committee notes that several of the comments above are addressed by advice in ANAO's *Asset Management Handbook*.

4.41 The issue of alternative methods of asset disposal was not raised in evidence. However, the Committee endorses ANAO's comments on this topic, especially the point that disposal should be planned, accountable and transparent, and disposal performance reviewed.<sup>23</sup>

4.42 The Committee believes that, as asset management improves in agencies, the written down value at disposal will more closely match returns.

#### Potential savings from improved asset management

4.43 The rewards arising from improved asset management can be substantial.

4.44 An example of the level of savings was provided at the Committee's public hearing by Defence witnesses. Mr Tonkin, Deputy Secretary Corporate, advised that the Defence Reform Program had identified 33 bases which were no longer required and their disposal would yield one-off gains of \$400 million. In addition, there would be an efficiency gain of about \$140 million per year in reduced overheads.<sup>24</sup>

22 ANAO, *Transcript*, p. 8; DoFA, *Submission*, p. S86; Coopers & Lybrand, *Transcript*, p. 23.

23 ANAO, *Asset Management Handbook*, pp. 46-8.

24 Defence, *Transcript*, p. 37.

4.15 At an agency level, the submission from Domain Consulting indicated that the potential life cycle savings from correctly adopting full asset management processes was approximately ten to twenty per cent of the annual holding cost of the assets.<sup>25</sup> At the Commonwealth level the submission from Coopers & Lybrand stated:

*... improved asset management practices could have the effect of:*

- *increasing the utilisation of existing assets, allowing say 5% of existing physical asset holdings to be disposed of. This would generate capital returns of some \$3.5 billion, and save nearly \$200 million every year in operating costs*
- *reducing expenditure on new asset acquisitions. A reduction of 5% would yield savings of approximately \$350 million every year*
- *improving service quality, by utilising an asset stock that is tailored to its purpose and well managed.*<sup>26</sup>

4.16 The Commonwealth's holding of non-military assets amounts to some \$32 billion. Even if the percentage returns suggested above are an over estimate, the potential benefit to the Commonwealth of improved asset management is substantial.

4.17 The Committee therefore endorses ANAO's *Asset Management Handbook* as a basis for agencies asset management practices and suggests that agencies should benchmark their asset management strategies and manuals against this document.



Bob Charles MP  
Chairman  
1 July 1998

25 Domain Consulting, *Submission*, p. S36.

26 Coopers & Lybrand, *Submission*, p. S67C.

# I

## APPENDIX 1 - SUBMISSIONS

- 1 Department of Health and Family Services,  
Therapeutic Goods Administration
- 2 Note Printing Australia
- 3 Comcare Australia
- 4 Australian Electoral Commission
- 5 Note Printing Australia
- 6 Comare Australia
- 7 Centrelink
- 8 Dr Penny Burns, AMQ International
- 9 Mr Wayne Edgtton, Domain Consulting Pty Ltd
- 10 Department of Foreign Affairs and Trade
- 11 Australian Electoral Commission
- 12 Department of Finance and Administration
- 13 Department of Defence
- 14 CSIRO
- 15 Mr Graham O'Loughlin, Coopers & Lybrand
- 16 Joint House Department
- 17 Department of Health and Family Services
- 18 Mr Graham O'Loughlin, Coopers & Lybrand
- 19 Centrelink



- 20 Department of Finance and Administration  
 21 Department of Finance and Administration  
 22 Department of Finance and Administration



## APPENDIX II - EXHIBITS

- 1 *Asset Valuation by Government Trading Enterprises: An Evaluation of Pricing Issues—Australian Society of Certified Practising Accountants' Public Sector Accounting Centre of Excellence*
- 2 *Asset Valuation Guidelines—exposure draft: guidelines for the valuation of depreciable assets in the general Government Sector—Department of Finance and Administration*
- 3 *Corporate Plan 1997-2000—Joint House Department*
- 4 *Total Asset Management Plan 1996—Joint House Department*
- 5 *1996-97 Annual Report—Joint House Department*
- 6 *Energy Management in Parliament House—Joint House Department*
- 7 *Transcript of Committee briefing by the Australian Society of Certified Practising Accountants, 2 April 1998*
- 8 *Comcover: An introduction to the Commonwealth's new insurable risk managed fund—Department of Finance and Administration*
- 9 *Asset Management Series—Principles, Policies and Practices, Catalogue of Reference—Victorian Department of Treasury and Finance*



## APPENDIX III - WITNESSES

Monday 20 April 1998

*Australian National Audit Office*

Mr Bill Nelson  
Acting Auditor-General

Mr Andrew Greaves  
Acting Executive Director, Business Assurance Services Group

Mr Edward Hay  
Group Director, Business Assurance Services Group

*Australian Society of Certified Practising Accountants*

Ms Rhonda Waller  
Manager, ACT Division

Mr David Hope  
Member, Public Sector Accounting Centre of Excellence

*Centrelink*

Mrs Diane Fielding  
National Manager, Finance

*Coopers & Lybrand*

Mr Graham O'Loghlin  
Director, Property Group

*Department of Defence*

Mr Walter Lewincamp  
First Assistant Secretary, Resources and Financial Programs

Mr Robert Tonkin  
Deputy Secretary Corporate

*Department of Finance and Administration*

Mr Mike Darcy  
Director, Accounting and Reporting,  
Accrual Budgeting Project

Mr Neville Jackson  
Director, Accounting and Governance Framework Section

Mr Brett Lennon  
Branch Manager, Policy, Accrual Budgeting Project

Mr Graham Millar  
Branch Manager, Financial Framework Branch

*Department of Foreign Affairs and Trade*

Mr David Peirce  
Acting Assistant Secretary, Financial Management Branch

*Domain Consulting Pty Ltd*

Mr Wayne Edgton  
Director